

General Information Letter: The sales factor cannot be negative.

June 12, 2000

Dear:

This is in response to your letter dated May 31, 2000 in which you request a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which may be viewed on our website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Your letter states as follows:

In accord with 2 Ill. Admin. Code 1200.120(b) and (c), we respectfully request assistance in applying §100.3380(b)(6), which addresses the inclusion of the net gains from sales of business intangibles in the sales factor of the apportionment formula. We understand that your response will constitute a general information letter, which is not binding on the Department of Revenue, and cannot, therefore, be relied upon as authority.

This particular code section states that sales of business intangibles should only be included in the sales factor of the apportionment formula to the extent of the net gain (loss) from such transactions. Our question concerns how the losses from such transactions enter into this computation in different scenarios.

Situation 1: A capital gain of \$10,000 from the sale of an intangible asset is attributable to Illinois. Two other sales of intangibles, both attributable to locations outside Illinois, resulted in net losses of \$3,000 and \$1,000. There are no other receipts for the period. All income for the period is classified as business income.

We believe the numerator of the factor is 10,000 and that the denominator is 6,000 ( $10,000 - 3,000 - 1,000$ ). The resultant factor as computed would then be 167%, which would be limited to 100% for apportionment purposes.

Situation 2: A capital loss from the sale of an intangible of \$5,000 is attributed to Illinois. A capital gain from the sale of an intangible of \$3,000 is attributed to a source outside Illinois. Sales attributed to locations other than Illinois of \$4,000 also occur during the period. All income is business income.

In this case, the numerator of the sales factor is -5,000, and the denominator is 2,000. ( $-5,000 + 3,000 + 4,000$ ) However, the sales factor is 0%, since a negative factor is prohibited.

Situation 3: A net capital loss from an intangible of \$20,000 is attributed to Illinois. Other receipts attributed to Illinois are \$8,000. There are no other gains or losses from the sales of intangible assets. Total other receipts, including those attributed to Illinois, are \$30,000. All income is business income.

In this case, the numerator of the factor is -12,000, since the net loss is netted against other gross receipts. The denominator of this factor is

10,000.  $(-20,000 + 30,000)$  As in situation 2, the sales factor is 0%, since a factor cannot be less than 0%.

## **RULING**

### **A. Applicable Law**

Section 304(a) of the Illinois Income Tax Act ("the IITA"; 35 ILCS 5/101 *et seq.*) sets forth the general rule by which the business income of a nonresident is apportioned where such income has been derived from Illinois and one or more other states. That section states in part:

If a person other than a resident derives business income from this State and one or more other states, then, for tax years ending on or before December 30, 1998, and except as otherwise provided by this Section, such person's business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the sum of the property factor (if any), the payroll factor (if any) and 200% of the sales factor (if any), and the denominator of which is 4 reduced by the number of factors other than the sales factor which have a denominator of zero and by an additional 2 if the sales factor has a denominator of zero. For tax years ending on or after December 31, 1998, and except as otherwise provided by this Section, persons other than residents who derive business income from this State and one or more other states shall compute their apportionment factor by weighting their property, payroll, and sales factors as provided in subsection (h) of this Section.

The sales factor is defined at IITA section 304(a)(3)(A) as "a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year." The term "sales" is defined at IITA section 1501(a)(21) to mean all gross receipts not specifically allocated as nonbusiness income or otherwise.

Pursuant to IITA section 304(a)(3)(B-2), gross receipts from the sale of certain intangible personal property may be included in the numerator or denominator of the sales factor only if gross receipts from sales of such items comprise more than 50% of the taxpayer's total gross receipts included in gross income during the tax year and during each of the 2 immediately preceding tax years.

Illinois income tax regulations contain certain special rules with respect to the sales factor (See 86 Ill. Adm. Code 100.3380(b)). Included among such rules is regulations section 100.3380(b)(6), which provides as follows:

In the case of sales of business intangibles (including, by means of example, without limitation, patents, copyrights, bonds, stocks and other securities), gross receipts shall be disregarded and only the net gain (loss) therefrom shall be included in the sales factor.

In addition, regulations section 100.3380(b)(2) provides that substantial amounts of gross receipts arising from incidental or occasional sales of assets used in

the regular course of the taxpayer's trade or business shall be excluded entirely from the sales factor.

The IITA also contains provision for alternative apportionment methods in any case where the statutory method applied does not fairly represent the taxpayer's business activity in Illinois. Namely, section 304(f) states:

If the allocation and apportionment provisions of subsection (a) through (e) and of section (h) do not fairly represent the extent of the person's business activity in this State, the person may petition for, or the Department may require, in respect of all or any part of the person's business activity, if reasonable: (1) Separate accounting; (2) The exclusion of one or more factors; (3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

## **B. Analysis**

Applying the foregoing to each of the three situations presented here, it must first be determined that gross receipts from sales of intangible assets are not excluded entirely from the sales factor under either IITA section 5/304(a)(3)(B-2) or regulations section 100.3380(b)(2). Where such determination has been made, regulations section 100.3380(b)(6) requires that only the net gain (loss) from sales of business intangibles be included in the sales factor.

Applying regulations section 100.3380(b)(6) in Situation 1 results in a sales factor of approximately 1.67. However, it would not be inconsistent with the statutory definition of the "sales factor" set forth at IITA section 5/304(a)(3) for a taxpayer to have more "sales" in Illinois than "sales" everywhere. Accordingly, in Situation 1 the sales factor must be limited to 1.0. Note, however, that the taxpayer may petition for, or the Department may require, and alternative allocation method pursuant to IITA section 304(h) where the statutory apportionment provisions do not fairly represent the extent of the taxpayer's business activity in Illinois.

Applying regulations section 100.3380(b)(6) in Situation 2 results in a sales factor of approximately -2.5. However, since it would be inconsistent with IITA section 5/304(a)(3) for a taxpayer to have negative sales in Illinois, the sales factor must be limited to 0.0. Note, however, that the taxpayer may petition for, or the Department may require, and alternative allocation method pursuant to IITA section 304(h) where the statutory apportionment provisions do not fairly represent the extent of the taxpayer's business activity in Illinois.

Applying section 100.3380(b)(6) in Situation 3 results in a sales factor of approximately -1.2. As in Situation 2, the sales factor must be limited to 0.0. Note, however, that the taxpayer may petition for, or the Department may require, and alternative allocation method pursuant to IITA section 304(h) where the statutory apportionment provisions do not fairly represent the extent of the taxpayer's business activity in Illinois.

As stated above, this is a GIL. Accordingly, it does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not

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binding on the Department. If you are not under audit and wish to obtain a binding private letter ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of 2 Ill. Adm. Code 1200.110(b).

I hope this information is helpful. If you have further questions related to the Illinois income tax laws, visit our website at [www.revenue.state.il.us](http://www.revenue.state.il.us) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker  
Staff Attorney - Income Tax